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**SUPREME COURT  
STATE OF WASHINGTON**

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CERTIFICATION FROM UNITED STATES COURT OF APPEALS FOR THE  
NINTH CIRCUIT IN:

AFFILIATED FM INSURANCE COMPANY, a Rhode Island corporation,

Plaintiff-Appellant,

v.

LTK CONSULTING SERVICES, INC., a Pennsylvania corporation;

Defendant-Appellee.

U.S.D.C. W.D.Wa. Case No. CV-06-01750-JLR

Ninth Circuit Case No. 07-35696

*Plaintiff*  
**REPLY BRIEF OF APPELLANT  
AFFILIATED FM INSURANCE COMPANY**

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## **I. STATEMENT OF THE CASE**

It is undisputed in this case that no privity of contract existed between appellant, AFFILIATED FM INSURANCE COMPANY (hereinafter "Affiliated FM"), and respondent, LTK CONSULTING SERVICES, INC. (hereinafter "LTK").

The contract at issue, the *Monorail Concession Agreement*, was concluded between the City of Seattle and Affiliated FM's insured, Seattle Monorail Services ("SMS") in 1994. After that, LTK separately and independently contracted with the City of Seattle to provide the City with certain engineering services before the fire on May 31, 2004 (hereinafter "the fire") involving the Seattle Monorail. No provision in the *Monorail Concession Agreement* indicated it was for the benefit of any third party professional, engineer or otherwise, who might provide services in the future to the City of Seattle involving the Monorail (*i.e.*, after conclusion of the Monorail Concession Agreement in 1994).

## **II. LEGAL ARGUMENT IN REPLY**

### **A. Property Interest.**

The legal question in this case is not who the Seattle Monorail "belonged to." The question is whether Affiliated FM's

FM's insured, SMS, had a sufficient possessory interest in the Monorail to justify suing LTK in tort.

LTK claims that the Ninth Circuit has held, for purposes of this appeal, that Affiliated FM's interest in the Monorail was a contractually-created economic loss, not damage to Affiliated FM's insured's property. The Ninth Circuit made no such holding. If it had, there would be no reason for this certification. In fact, the Ninth Circuit characterized *the parties' contentions* as follows:

In this case, the loss suffered is "economic" or "commercial" in that SMS suffered harm to its contractually-created economic interest in operating the Monorail. However, AFM argues that SMS's right to operate the Monorail exclusively is more like a "property interest" and that the economic loss rule should therefore not apply because SMS's interest is not purely "economic." No Washington State Supreme Court precedent explains the degree of interest one must have in property to bring suit in tort for damage to that property.

*Affiliated FM Ins. Co. v. LTK Consulting Services, Inc.,*

Certification Order, p. 1854

Black's Law Dictionary defines *sui generis* as "one of a kind". The Seattle Monorail is one of a kind; the agreement between the City of Seattle and SMS to operate it is not.

The federal district court below held, without citation to any legal authority, that the *Monorail Concession Agreement* was more like a license than a lease. The federal district court, however, never afforded the *Monorail Concession Agreement* some unicorn-like status. In fact, in categorizing what type of agreement the *Monorail Concession Agreement* qualified as, the federal district court only considered whether this agreement was a lease or a license. LTK rhapsodizes in its answering brief that "the world of contracts contains more than these two categories." Indeed, the world of contracts does. However, the only two categories relevant to this lawsuit are those of leases and licenses.

LTK argues that the *Monorail Concession Agreement* uses none of the magic words that would indicate it was a lease. However, the most authoritative case decided by the Washington Supreme Court on the subject, *Barnett v. Lincoln*, 162 Wash. 613, 617, 299 Pac. 392 (1931), stated no particular words, technical or otherwise, are necessary to constitute a lease and the existence of landlord and tenant is primarily a fact question to be determined from the intent of the parties. LTK ignores this point altogether. Furthermore, the court in the *Barnett* decision held that if exclusive possession or control of the premises, *or a portion thereof*, is granted, even though the use is restricted by

reservations, the instrument at issue will be considered a lease, not a license. *Id.*

LTK does not dispute that Affiliated FM's insured had the exclusive right under the *Monorail Concession Agreement* to operate the Monorail. No one else but Affiliated FM's insured, could turn it on, operate it between the Seattle Center and the Westlake Center, and accept fares for traveling on the Monorail.

LTK argues that the *Monorail Concession Agreement* is not a lease because the agreement did not give Affiliated FM's insured exclusive possession over the Monorail trains, tracks or buildings. The fatal flaw in this argument is that a lessor, in leasing an improvement to real property, retains the common law right to re-enter the premises during the term of the lease to make repairs. *Friedman on Leases*, §37:1.1, p.37-3 (5<sup>th</sup> ed. 2009). Consequently, the City of Seattle's retention of the right to re-enter any premises where the Monorail was being operated does not thereby disqualify the Monorail Concession Agreement from being considered a lease.

LTK argues that a lessee does not have a sufficient possessory interest in the property leased to sue in tort for damages to the property being leased. LTK cites no legal authority for this proposition because there is none.

A general covenant to repair obligates the tenant to make all necessary repairs to the property being leased. *Publishers Building Co. v. Miller*, 25 Wn.2d 489, 172 P.2d 489 (1946). In this instance, Affiliated FM's insured agreed to repair the Seattle Monorail in the event it was damaged by fire. ER 057, 065. A redelivery clause is breached if, when the term ends, the leased property is not returned in the agreed state of repair. *Schafer Brothers Land Co. v. Universal Pictures Corp.*, 188 Wash. 33, 40, 61 P.2d 593 (1936). In this instance, Affiliated FM's insured had an obligation to return the Seattle Monorail in an undamaged condition, except for any reasonable wear and tear, to the City of Seattle at the expiration of the *Monorail Concession Agreement*. ER 101. Given these obligations, a lessee has the right to sue the party responsible for proximately causing property damage to the leased premises. See e.g. *Johnny's Seafood Co. v. Tacoma*, 73 Wn. App. 415, 869 P.2d 1097 (1994).

LTK also exhibits a profound lack of understanding with respect to the terms and conditions in car rental agreements. Such agreements uniformly require the renter of the vehicle to return it to the car rental company in an undamaged condition (similar to the common redelivery clause found in a commercial lease. See *Rizzutto v. Morris*, 22 Wn. App. 951, 592 P.2d 688

(1979)). If the car is damaged during its rental, then the renter is financially responsible to the car rental company to pay for those damages. Using LTK's hypothetical, if a rented car is improperly worked on by a mechanic causing damage to the car while being operated by the car renter, the car renter could most certainly be able to sue the mechanic for any damage done to the car during its rental. This is because ultimately the car renter is financially responsible to the car rental company for any damage to the car that occurs during the time it is being rented. On the other hand, a hotel lodger does not enter into such an arrangement when he or she rents a room in a hotel. In this instance, Affiliated FM's insured had an obligation to return the Seattle Monorail in an undamaged condition to the City of Seattle at the expiration of the *Monorail Concession Agreement*.

LTK states that the *Restatement of Property* §521(2)(1944) does not stand for the proposition that a license agreement conveys a sufficient legal interest in property to sustain a tort action against a third party that damages the property that is subject to the license. "Protection from interference" includes protection against tortiously damaging the subject of the license. And, as hard as LTK runs from the fact,

LTK is the type of third party to a license agreement that section 521(2) is aimed to protect against.

LTK's characterization of the decision in *McInnes v. Kennell*, 47 Wn.2d 29, 286 P.2d 713 (1955) misses the point. First, LTK does not seem to understand another Seattle icon: houseboats on Lake Union. A houseboat on Lake Union is literally a house floating on logs; it is not a boat. The plaintiff in the *McInness* case pursued a nuisance action against the defendant. A nuisance action sounds in tort. The defendant brought a counterclaim for trespass. Again, a trespass action sounds in tort. In ordering that plaintiff remove several houseboats that encroached upon property which the defendant had a right to occupy, this Court stated in the *McInness* decision, "Where, as in this case, the exercise of a license requires exclusive possession of the property, a court may exercise its broad equity power to protect the rights of the licensee. Restatement, Property, §521." Defendant's possessory interest was considered by the court in the *McInness* decision to be sufficient enough to afford defendant a remedy in tort under a theory of trespass: removal of the offending houseboats. In like fashion, in the instant case this Court should find that Affiliated FM's insured's possessory interest in the Monorail is sufficient to

allow Affiliated FM to pursue the present subrogated action sounding in tort for damages to the Monorail caused by the fire. Parenthetically, it should be noted that if a party has exclusive possession or control over the piece of property in question, the agreement conferring such a right is more properly characterized as a lease, not a license. *Barnett v. Lincoln*, 162 Wash. 613, 299 Pac. 392 (1931).

LTK argues that the question of whether Affiliated FM had an insurable interest in the Seattle Monorail has “never been tested adversarially.” This argument cannot have been put forward in good faith. As LTK points out in its own brief, a declaratory judgment action was filed in federal district court to determine if portions of the damaged Monorail were covered by Affiliated FM’s policy. If Affiliated FM’s insured did not have an insurable interest in the Monorail to begin with, then the damage to the Monorail would not have been covered under Affiliated FM’s policy to begin with. Affiliated FM would consequently not have been obligated to make any payment for damage to the Monorail, and it would have no right of subrogation to pursue in this lawsuit.

LTK does not dispute that if Affiliated FM’s insured had an insurable interest in the Seattle Monorail, then that interest

should be sufficient to allow Affiliated FM to pursue its right of subrogation in this case by suing LTK in tort for damages stemming from the fire. Furthermore, LTK does not explain how making the City of Seattle a loss payee under Affiliated FM's property insurance policy obviates its insurable interest in the Seattle Monorail. A loss payee gains no legal interest in the proceeds payable under an insurance policy; it simply is given the right to receive payments made under the policy first. *Higgins v. Scottsdale Ins. Co.*, 127 Wn. App. 486, 497, 111 P.3d 893 (2005). Thus, the City of Seattle's status as a loss payee under Affiliated FM's insurance policy does not affect, one way or the other, whether Affiliated FM has an insurable interest in the Seattle Monorail.

**B. Economic Loss Doctrine.**

LTK argues that contractual privity is not a necessary element in order to apply the economic loss doctrine. Division Three of the Washington Court of Appeals in *Baddeley v. Seek*, 138 Wn. App. 333, 156 P.2d 959 (2007), held otherwise.

LTK argues that the Washington Supreme Court held in *Berschauer Phillips Construction Co. v. Seattle School District No. 1*, 124 Wn.2d 816, 881 P.2d 986 (1994), that privity of contract is not a prerequisite to the application of the economic

loss doctrine. However, LTK conveniently overlooks the fact that the plaintiff general contractor's ability to bring the lawsuit involved in that case in the first place was based on a direct assignment of the School District's contractual rights against the design professionals (architect, structural engineer, testing service) to the general contractor. Without such an assignment, the general contractor would have had no contractual right to bring the lawsuit against the design professionals. Since the general contractor had secured by way of assignment the right to assert contractual remedies against the design professionals, the Washington Supreme Court held that the general contractor's remedies against the design professionals were only those contractual remedies assigned by the School District to the general contractor. Thus, the general contractor was not left without a remedy, but only a remedy that could be pursued under a breach of contract theory.

What is so pernicious about LTK's attempt to apply the economic loss doctrine in this case is that it is intended to leave Affiliated FM's insured, and by extension Affiliated FM, without any legal remedy whatsoever for the damages to the Seattle Monorail in the event the Monorail is damaged by fire. As LTK concedes, it had no direct contractual arrangement with Affiliated

FM's insured and cannot be considered a third party beneficiary under the *Monorail Concession Agreement* concluded between Affiliated FM's insured and the City of Seattle. Nevertheless, LTK argues that Affiliated FM's insured has no legal remedy against LTK if LTK's negligence is responsible for the fire. LTK points to nothing in the *Monorail Concession Agreement* that requires Affiliated FM's insured to indemnify the City of Seattle for damages to the Seattle Monorail caused by LTK's negligence. In point of fact, the City of Seattle is vicariously liable for LTK's negligence. LTK points to nothing in the *Monorail Concession Agreement* that exonerates LTK from legal responsibility for damages to the Seattle Monorail caused by LTK's negligence. LTK points to nothing in the Monorail Concession Agreement that would constitute a waiver of subrogation that would bar the present suit. In short, LTK points to nothing in the *Monorail Concession Agreement* that explicitly states that Affiliated FM's insured must ultimately be solely responsible for damage to the Seattle Monorail caused by LTK's negligence. LTK points to nothing in the *Monorail Concession Agreement* that can be reasonably construed as an obligation by Affiliated FM to assume legal liability for damages caused by

third parties, like LTK, whose actions Affiliated FM's insured had no legal control over.

Rather, LTK argues the economic loss rule bars actions in tort where the defendant's (*i.e.*, LTK) duty of performance arises solely from a contract and the plaintiff claims an economic injury from the contract's inadequate performance. LTK never entered into a contract with Affiliated FM's insured and was never a third party beneficiary under the agreement concluded between Affiliated FM's insured and the City of Seattle. LTK's duty in this case was its independent common law duty to exercise reasonable care in the engineering decisions it made concerning a renovation to the Seattle Monorail such that the renovation would not proximately cause a fire. Affiliated is not pursuing an economic injury in this case; it is suing LTK for \$3.2 million in **physical** property damages stemming from the fire. Affiliated FM is not alleging any breach of the contract between LTK and the City Seattle for the renovation of the Seattle Monorail; it is suing LTK for engineering malpractice associated with this renovation and the corresponding **physical** property damages proximately caused by the fire.

*Berschauer Phillips Construction Co. v. Seattle School District No. 1*, 124 Wn.2d 816, 881 P.2d 986 (1994), specifically

held that recovery of economic loss *due to construction delays* was limited to the remedies provided by contract. *Id.*, 124 Wn.2d at 826. As the court in the *Berschauer* decision observed, the case before it did not involve either personal injuries or physical harm to property, but purely economic loss. *Id.*, 124 Wn.2d at 819. Furthermore, the *Berschauer* decision held that “when parties have contracted to protect against potential economic liability, as is the case in the construction industry, contract principles override tort principles in (Restatement (Second) of Torts §) 552 and, thus, purely economic damages are not recoverable.” *Id.*, 124 Wn.2d at 828.

Here, the damages were caused by a fire. The fire caused extensive **physical harm**, not “economic losses” based on a perceived dissatisfaction with the manner in which the contract was performed. There is nothing in the *Monorail Concession Agreement* to indicate that Affiliated FM’s insured and the City of Seattle agreed to any provision in that agreement that explicitly allocated the risk of physical harm to the Seattle Monorail solely to Affiliated FM’s insured in the case of LTK’s negligence. As pointed out earlier, there is no indemnity clause, exculpatory clause or waiver of subrogation exonerating the City of Seattle from any liability for physical damages caused by

LTK's negligence and, instead, imposing that liability solely on Affiliated FM's insured. If there was, then certain well defined principles would apply, such as: (1) indemnification against one's own negligence in the construction setting is unenforceable [RCW 4.24.115]; (2) the test in Washington to determine if exculpation from future liability due to one's own negligent conduct is enforceable [*Wagenblast v. Odessa School District*, 110 Wn.2d 845, 758 P.2d 968 (1988)]; and (3) the scope of any waiver of subrogation is limited to only the work contracted for. *PEMCO v. Sellen*, 48Wn. App. 792, 740 P.2d 913 (1987).

In light of this blaring absence, LTK nevertheless argues Affiliated FM's insured "elected to assume financial exposure for repairs of all sorts, no matter who caused the damage." However, LTK does not bother to point out where in the *Monorail Concession Agreement* Affiliated FM's insured supposedly decided to agree to this "heads you win, tails I lose" provision. This is because there is no such provision in the *Monorail Concession Agreement* evidencing any such intent. The only contractual provisions relied upon by LTK at all in its brief are: (1) the City's retention of the right to enter the property and "adjust operation" of the Monorail system as necessary; and (2) the "right", but not the obligation, to make repairs,

improvements, alterations and additions to the Monorail system. Under no stretch of any reasonable imagination can either of these two provisions be construed to conclude Affiliated FM's insured agreed to solely assume the financial responsibility for repairs of all sorts, no matter who caused the damage. It would therefore be extremely unfair to hold that Affiliated FM and its insured cannot sue LTK for negligently causing the fire due to a non-existent provision in the *Monorail Concession Agreement*. This is particularly the case in a state where, in the construction industry, one cannot contractually obligate one party to indemnify the other party for damages caused by the other party's negligence.

Finally, LTK objects to this court considering how other states have applied the economic loss doctrine to the particular circumstances involved in this case. This objection includes, by implication, considering how California, the state that invented the economic loss doctrine, would apply it in this case. California would not. Or, how other states, like Florida, have, upon reflection, come to realize that the economic loss doctrine has been misinterpreted to bar well-established causes of action, such as those for professional malpractice that lead to tangible and extensive physical damages. Consideration of how other

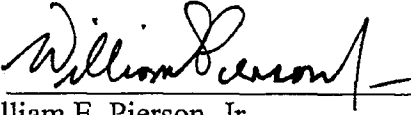
states have decided to apply the economic loss doctrine to the circumstances involved in this case does not “address issues outside the question” certified by the Ninth Circuit. Rather, it hopefully underlines how foolish LTK’s arguments are for the application of the economic loss doctrine in this case.

### **III. CONCLUSION**

The federal district court below erred as a matter of law in dismissing Affiliated FM’s lawsuit against LTK. At the time of the fire, there was no contractual relationship between Affiliated FM’s insured and LTK. Affiliated FM’s insured had a sufficient possessory interest in the Seattle Monorail to sustain a tort action against LTK. The damages Affiliated FM is pursuing in this case are property damages compensable in tort, not “economic losses” compensable only in a breach of contract action. Under these circumstances, the economic loss doctrine has no application under the substantive law of the state of Washington to the present lawsuit. This Court should therefore answer the question certified in this appeal by the Ninth Circuit in the affirmative.

DATED this 20<sup>th</sup> day of April, 2009.

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